CHAPTER 10: LEVERAGED LOANS

SECTION 1: UNDERSTANDING LEVERAGED LOANS

10.1 OVERVIEW

A leveraged loan is an Agency loan that is supplemented by a loan or grant from another funding source that is provided at the same time the Agency loan is closed. Leveraging reduces the loan amount the Agency must provide to help an applicant obtain adequate housing. The additional funding source may be a private lender that provides home financing at market rates and terms, a State or local government, or a nonprofit organization that provides subsidized loans or grants. Leveraged loan payment, security, and processing requirements may vary from non-leveraged loans as provided in this chapter. This chapter provides basic information about leveraging and describes the modifications to regular loan processing procedures that are made when a loan is to be leveraged.

A. Advantages of Leveraged Loans

Leveraged loans offer advantages to both the Agency and applicants. By combining its resources with those of other lenders, the Agency can assist more borrowers. For this reason, loan packages that receive supplemental funding from an Agency recognized source will receive a processing priority when the supplemental funding reduces the amount otherwise needed from the Agency by at least 20 percent with loan funds or 15 percent if entirely grants, forgivable loans or deferred payment loans. See Paragraph 3.13 B.

Who Can Be a Participating Lender?

"Lender," as it is used in this chapter, refers to an organization that provides long term, amortized loans for housing, including private lenders, State and local governments, and nonprofit organizations. The Agency encourages grant funding when it is available. However, a grant provider is not considered a "lender."

For some applicants, purchasing a home through a leveraged loan will be the first opportunity to establish a relationship with a private lender. For other applicants, combining the Agency loan with a grant or low-interest loan from another subsidy program may be the only way to make homeownership possible. Leveraging is especially encouraged in the case of assumptions on new rates and terms, since the applicant may be able to obtain a non-Agency loan for purchase costs above the outstanding balance to be assumed. Attachment 10-A provides an example of an Agency loan leveraged with private financing.

B. Two Separate Financial Agreements

When a loan is leveraged, each lender enters into a separate financial agreement with the applicant. The combined resources that are provided enable the applicant to purchase a home. Although each lender remains responsible for final underwriting decisions for its loan, the application and underwriting processes should be streamlined whenever possible to avoid duplication of effort and extra burden on the applicant.

10.2 SOURCE OF LEVERAGED FUNDS

Agency funds may be supplemented by funds from a variety of sources. One of the challenges for the Loan Originator will be to understand the implications for the applicant and the Agency of the requirements that may be imposed by these sources.

A. Market Rate Financing

Market rate financing may be appropriate under some circumstances. The applicant's repayment ability must be considered in determining whether it is appropriate for referral to market rate sources. Private lenders generally have a variety of loan products that are tailored to fit specific circumstances, for example, different products for new purchases, refinancing, and home improvement loans. The private lender loan must be a long-term, fixed rate mortgage of at least 30 years or a term no shorter than 15 years with a balloon payment and installment based on at least a 30-year amortization schedule. The Agency will not accept an adjusted rate mortgage (ARM) or an interest only mortgage. The Agency will not participate in loan packages that involve interest rates that are more than 2% (200 basis points) above the Agency note rate. Loan Originators may need to work with the lender and applicant to identify an appropriate loan product that meets lender and Agency requirements.

B. Other Subsidized Financing

Although there are many variations in the specifics, the subsidized funds that can supplement Agency funds will generally come in one of the forms described below.

- **Grants without long-term restrictions.** Some grants are provided with no restrictions, as long as the applicant is eligible and the funds will be used for an eligible purpose.

- **Forgivable loans.** Some sources provide funds that require repayment only if the home buyer fails to comply with program requirements or restrictions. For example, a funding source may provide funds for a down payment or rehabilitation that need not be repaid if the home buyer remains in the property for a specified period of time. The funds are generally provided as a loan to permit the funding agency to record the circumstances under which repayment is required.

- **Deferred payment loans.** Deferred payment loans may be used to provide funds that are repaid only upon transfer of the property or as a balloon payment at the end of a specified period. These funding arrangements often include a provision for the funding source to share any appreciation that occurs with the home buyer.

- **Amortizing low interest loans.** In many areas, low-interest loans are offered by State and local government agencies. These loans require repayment on a monthly basis and may include provisions for the funding source to share in any appreciation.

Grants, forgivable loans, deferred payment loans, and any other nonamortizing loans are not considered in calculating the monthly principal, interest, taxes, and insurance (PITI) or total debt (TD) ratios. The Agency's ability to recapture subsidy funds may be affected by the provisions of these loans. Agency loans should be subordinated only in the case of an amortizing loan of 20 to 30 percent of the total transaction. While an applicant may obtain a loan from another source of less than 20 percent of the total transaction, such a loan **would not** receive benefits such as lien priority, Equivalent Interest Rate (EIR), or processing priority. Further, USDA payment assistance is used to make the home affordable rather than to make the participating financing affordable.

10.3 KEY DIFFERENCES IN POLICIES AND PROCEDURES

This paragraph highlights major policy and procedural differences between qualifying leveraged loans and other participation loans. Detailed processing guidance for originating leveraged loans is provided in Section 2 of this chapter.

A. Eligible Loans and Grants

Cash contributions by the applicant, gifts from individuals, and donations of land do not count as leveraged or participation amounts. These are applicant contributions. Subsequent loans cannot be leveraged unless they are used in conjunction with assumptions on new rates and terms.

The Agency will not consider leveraging arrangements with market-rate financing sources in which the lender's loan amount is less than 20 percent or greater than 50 percent of the combined transaction amount. When all the leveraging consists of subsidized financing (affordable housing products, such as down payment assistance, forgivable loans, etc.), the minimum acceptable leveraging is 15 percent.

Other financing totaling less than 20 percent for lenders or 15 percent from other subsidized housing assistance is permissible. However, Rural Development will not subordinate its lien position to the lender nor automatically provide the Equivalent Interest Rate (EIR) in calculating payments to the borrower if the loan is less than these required thresholds. However, these loans will receive processing priority when funds are limited.

B. Lien Position

To encourage participation by other lenders, the Agency will subordinate its lien position to a leveraged lender providing at least 20 percent of the financing. However, liens related to other subsidized funds provided in the form of grants and nonamortizing loans, such as deferred payment or forgivable loan, must be subordinated to the Agency's loan. In those cases where there is a soft, silent or forgivable lien, the total debt may exceed the market value as prescribed in Paragraph 6.7 F.

C. Payment Assistance Calculation

For loans where at least 20 percent of the total of the purchase price plus eligible closing costs is financed by another lender **or** at least 15 percent with affordable housing products, payment is automatically calculated using the Equivalent Interest Rate (EIR) without consideration of the floor payment. UniFi makes this adjustment when a qualifying leveraged loan is identified.

D. Availability of Mortgage Credit Certificates (MCC)

Under current tax law some State and local issuers of mortgage bonds may issue MCC to provide a Federal income tax credit to assist low-income home buyers and home owners. The credit permits an eligible household to claim a specific percentage of the annual interest paid on a mortgage as a tax credit rather than a deduction. If an applicant will receive the credit, the benefit of the credit may be considered when completing the "grossing up" income calculation described in Paragraph 4.4 H. MCCs are issued through private lenders.

E. Section 8 Housing Choice Vouchers (HCV)

Housing Choice Vouchers may be used with or without a leveraged loan. The voucher itself is not considered leveraging and generally would not count toward the 15 percent requirement for affordable housing products to obtain leveraged benefits, such as EIR or processing priority.

F. Origination

Many processing steps can be conducted by the participating lender, rather than Agency staff. For example, the Agency may accept application and income information provided by the lender and permit the participating lender to conduct appraisals and inspections when the lender has some risk of loss at stake, based on applicant repayment or over-valuation of the security. However, even when the Agency relies on the work of the participating lender, it retains internal control, final underwriting, and loan approval responsibility for the Agency loan. Responsibility for compliance with environmental requirements remains with the Agency, although the lender may be asked to assist in collecting needed environmental information. Section 2 of this chapter provides detailed processing guidance for originating leveraged loans.

G. Servicing

Leveraged loans are eligible for the same servicing actions as any other Section 502 loan. It is imperative that any leveraging arrangement be structured so that applicant rights are preserved. However, servicing strategies may be different because of the Agency's lien position and the need to coordinate servicing strategies with the participating lender.

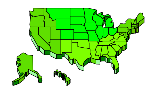
1. Tax Service Fee (Tax and Insurance Escrow)

The Agency will collect a tax service fee on all leveraged loans. Either the participating lender with at least 20 percent of the total amortized loan amount or the Agency may maintain the escrow account. Lenders with less than 20 percent and all affordable housing product agencies **may not** maintain the escrow account. When necessary, the Agency may make advances to pay taxes or insurance premiums.

The Agency is customarily in a subordinate lien position with the largest portion of the loan amortized for the longer term and is at more risk than the other lender. An exception to this may be agreed to with the prior lien holder when the tax service vendor agrees in writing to cover both the Agency's and the leveraged lender's loans. The vendor must also agree to make annual real estate tax searches and report any delinquencies to the Centralized Service Center in St. Louis, Missouri.

2. Special Servicing

The Agency will aggressively pursue all available special servicing remedies to help solve applicant problems. If foreclosure is necessary, each lender has an independent responsibility to protect its interest. *Form RD 1927-8, Agreement with Prior Lienholder,* which must be executed and recorded in the appropriate Real Estate Mortgage Records, requires the participating lender to notify the Agency before accelerating any loan and permits, but does not require, the Agency to pay or reinstate the prior lien to protect the Agency's interest.

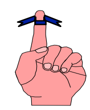


10.4 DEVELOPING STATE-BY-STATE APPROACHES TO LEVERAGING

The way in which leveraging is most effectively handled will vary state-to-state and community-to-community, depending upon market conditions, the availability of Government subsidy funds, and the interest of private lenders. For this reason, each State Director should develop an independent leveraging strategy that will encourage and facilitate the use of leveraged loans.

Elements of an Effective Lending Strategy

- Lender Outreach and Marketing
- Effective Borrower Education
- Streamlined Processing Procedures



A. Lender Outreach

Each state should implement lender outreach activities that encourage participation by all prospective lenders. For example, Field Staff should:

- Collect and maintain sales information for each market area that will enable the Loan Originator to assess whether applicants are candidates for 100 percent private financing or for leveraging.

- Identify lenders who are active in the State and provide information about the Agency's loan programs and how leveraging arrangements might work.

- Identify the sources of loan and grant funds that may be available from State and local governments, and nonprofit sources. Provide information on the Agency's loan programs to active and appropriate sources, and describe how leveraging arrangements might work.

- Consider maintaining lists of interested lenders, and information on their loan rates and terms. Care should be taken to provide information to applicants in a manner that does not provide preferential treatment to specific lenders or borrowers.

B. Borrower Education

Each State should develop briefing materials that explain the leveraging concept and why leveraging funds may be advantageous. Some applicants may need guidance and assistance in identifying and contacting appropriate non-Agency funding sources.

C. Streamlined Processing Procedures

Lenders will be less interested in working with the Agency if the leveraging process greatly increases their processing time or their documentation requirements. However, streamlining procedures must be balanced with prudent lending and internal control practices. Each Field Office should develop streamlined procedures for coordinating with participating lenders and for reviewing underwriting determinations made by those lenders. Each State Director should consider the following approaches:

- Develop a separate application package specifically for applicants seeking leveraged loans.

- Inform participating lenders in advance of the Agency's requirements for the qualification of appraisers, inspectors, and closing agents and, if requested, provide advance approval of lender staff or contractors who routinely provide these services for lenders' loans.

- Provide staff training to ensure expedited review of leveraged loans.

- Develop and enter into a Memorandum of Understanding (MOU) with active lenders covering basic policies and procedures, rather than operating on a loan-by-loan basis. See Attachment 10-B for a list of topics shat should be considered in developing a Memorandum of Understanding.

- The terms of the MOU, including requirements for leveraged loans outlined in this chapter, should be negotiated up front. A good MOU eliminates future misunderstandings, is a good public relations opportunity, and is strongly recommended for all partners. A copy of the MOU in each leveraged loan file is suggested.

- Over time, use information from MortgageServ to generate information about the performance of leveraged loans to inform lenders, and to adjust processing procedures. To assure this information is accurate and useful, inconsistencies (such as First National Bank v. 1st Natl. Bank) should be avoided. The leveraged lender ID field in Unifi, including the lender's Tax ID number, must be completed.

SECTION 2: ORIGINATING LEVERAGED LOANS

10.5 TAKING APPLICATIONS

If the applicant applies directly to the Agency, the application procedures described in Chapter 3 should be followed. When the applicant has already completed an application to another funding source, a copy of that loan or grant application may be accepted if the other funding source used a version of the Uniform Residential Loan Application (pages 1-5 of *Form RD 410-4*). However, the applicant also must complete *Additional Information Required for RHS Assistance*, pages 6 through 9 of *Form RD 410-4, Uniform Residential Loan Application*.

10.6 REFERRING APPLICANTS TO PARTICIPATING LENDERS

Because both loan and grant funds may leverage Agency financing, any applicant for an Agency loan is a potential candidate for leveraging. The Loan Originator should provide information about other sources of subsidized loans or grants to applicants. Applicants should be referred to entities offering affordable housing products such as grants, forgivable loans, deferred interest loans, and below-market interest rate loans when such funding sources are available in the local area for which they appear to qualify.

The applicant may be a candidate for a leveraged loan because they are working with or have already completed an application to another funding source prior to coming to the Agency for a loan.

10.7 DETERMINING APPLICANT ELIGIBILITY

> **Community Reinvestment Act (CRA)**
>
> CRA requires lenders to help meet the credit needs of the communities in which they are chartered to do business.

Applicants for Section 502 leveraged loans must meet the eligibility requirements described in Chapter 4. In addition, they may have to meet additional eligibility requirements imposed by participating lenders. Participating lender credit requirements may be more stringent than the Agency's, but the Loan Originator can encourage lenders to work with applicants who meet Agency requirements. In talking with the participating lender, the Loan Originator should stress that the Agency will be sharing risk with the participating lender and that the participating lender will hold the first lien position. Also, the lender may receive CRA credit for making loans in partnership with the Agency. Leveraged loans may be sold on the secondary market though the lender must notify Rural Development upon sale and assure the investor/buyer is aware of leveraging arrangements and all requirements.

10.8 ISSUING THE CERTIFICATE OF ELIGIBILITY

To issue *Form RD 1944-59, Certificate of Eligibility* in conjunction with a leveraged loan, the Loan Originator should follow the procedures described in Paragraph 4.25, with the following exceptions. For leveraged loans, *Form RD 1944-59* will contain:

- The total maximum loan for which the applicant qualifies -- not just the Agency's portion of that loan;
- The expected Agency and lender shares of funds to be provided; and
- A time frame of <u>60 days</u> for the applicant to identify a property -- 15 days longer than other applicants receive to allow time to work with the participating lender.

10.9 UNDERWRITING LEVERAGED LOANS

A. Lender vs. Agency Underwriting

> The Agency is responsible for making sound underwriting decisions regardless of another lender's participation.

There are many underwriting processes that may be performed by either the Agency or the lender, such as income verification, credit checks, and title clearance. Lenders should be allowed to do the primary legwork involved in collecting underwriting information, but only when all or a portion of their loan is at risk. Allowing lenders to collect underwriting information does not imply that the Agency is relieved of its responsibility to make sound underwriting decisions, only that information collected by the lender is generally acceptable to use in making these decisions.

B. Property Requirements and Appraisal

The property must meet all of the requirements described in Chapter 5. The Loan Originator may accept property inspections and appraisals conducted by the participating lender, as long as evidence of the qualifications of the individuals performing these activities is provided and accepted. The Loan Originator must still inspect the property to determine eligibility. An administrative review of the appraisal must be completed before the appraisal is accepted. The environmental review remains the responsibility of the Agency; however, the participating lender may be requested to provide environmental information.

C. Loan-to-Value Ratio

When loans are funded solely by the Agency, the applicant's total debt may exceed the market value of the property by the total of the Agency appraisal and tax monitoring fees, plus the required contribution to establish the escrow account. Down payments are required only if the applicant's nonretirement assets exceed $7,500 ($10,000 for elderly families) or available retirement assets exceed the applicable adjusted median income. (See Paragraph 4.7.)

Some lenders may be willing to participate in a loan when the total debt exceeds the value of the property because their risk is limited by the Agency's participation in the loan. However, others will require that applicants have some equity in the property, because they believe an investment in the property improves the likelihood that the applicants will fulfill their commitments. This means that applicants with leveraged loans may need to contribute more cash than other applicants. The Loan Originator should explain to the applicant whether a cash contribution will be necessary and work with the lender to lower their usual equity requirements.

D. Loan Terms and Fees

Lenders are expected to charge reasonable and customary interest rates and fees. The Loan Originator may be able to help the applicant negotiate favorable terms.

The leverage loan interest rate must be the rate the lender typically charges to its best mortgage applicant customers – an extra amount may not be charged because of low income or other high risk factors. The interest rate may be no more than 2 percent (200 basis points) above the Agency note rate in effect at loan closing. Also, the lender may not include “points” to buy down or pre-pay the interest. If funds are available from the applicant, they must be used to reduce the amount borrowed (reducing the cost to the government).

Non-Agency loans must be amortized over a 30-year period, but may contain provisions for a balloon payment at the end of the 15th year.

Loan fees must be kept as low as possible. All fees must be reasonable. “Underwriting fees” and similar add-ons are not permitted. The total fees paid to the lender may not exceed 3-1/2 percent of the lender’s loan. (This limitation on the lender applies regardless of whether the buyer or the seller pays the fees.) However, an additional amount may be considered when the lender does most or all of the loan packaging (including the Rural Development loan) and the additional amount is for reimbursements, such as fees for appraisals, inspections, etc.

In general, the loan originator must assure loan fees are minimized. The 3-1/2 percent is a maximum, not a baseline. The total Rural Development loan may not be considered when the lender is establishing fees. Lender fees must be commensurate with the amount of service provided by the lender.

E. Determining Loan Amount

The Agency loan may include costs for the initial contribution to the escrow account for taxes and insurance, even if the participating lender will manage the escrow account. The loan amount for leveraged loans is determined using the procedures described in Chapter 7, with the following exceptions.

- Payment assistance is computed using the appropriate Equivalent Interest Rate (EIR), but no floor payment.

- Agency loans leveraged with private financing should always be at the standard terms. If the loan is not affordable at standard rates and terms, the Agency’s share of the loan should be increased, rather than extending the loan term or reducing the EIR. Loans requiring 38-year repayment terms should never be leverage with market rate financing.

- Use the Agency’s cost for an appraisal to determine total allowable debt, even when the appraisal is performed by the participating lender’s appraiser.

- Packages involving affordable housing products or grants that primarily pay loan packaging fees or costs other than an eligible loan purpose, as defined in Chapter 6, do not count toward the 15/20 percent limitations for the loan to automatically receive the EIR and other leveraged loan benefits.

F. Agreements with the Participating Lender Regarding Construction

For loans that involve new construction or rehabilitation, the Agency and lender must agree on how construction inspections, payment draws, and final acceptance of the work will be handled. This may be accomplished by an agreement developed for the specific loan or through a general memorandum of understanding that covers multiple loans.

1. Inspections

Interim construction inspections completed by the participating lender may be accepted if the Field Office has approved the qualifications of the inspector. However, an Agency representative must participate in the final inspection. The participating lender may be asked to provide the Agency with a status report on implementation of any mitigation measures required by the Agency's environmental assessment; however, the ultimate responsibility for compliance rests with the Agency.

2. Construction Draws

Typically, construction draws should be made by each lender in proportion to the amount of the loan each is contributing. For example, if the Agency provides 60 percent of the loan and the participating lender 40 percent, 60 and 40 percent of each draw would be paid by the Agency and the participating lender, respectively. However, there are circumstances in which another arrangement would be appropriate. For example, a participating lender might prefer to fully fund the acquisition of the site at the beginning of the construction period. If the participating lender is unwilling to provide construction funding until the Agency loan funds have been used, the Agency can provide the construction funding up to the maximum amount of the Agency's loan.

10.10 LOAN CLOSING

The Agency loan approval official must review the leveraged loan package and the lender's "Good Faith Estimate" to determine if fees are reasonable and proposed use of loan funds is permissible. The loan approval official will not approve a transaction where the fees are questionable or excessive.

A joint closing generally will be held for Agency and participating lender loans. If the leveraged loan will close after the Agency loan is closed, a written, firm loan commitment from the participating lender must be provided to the Agency by the time of the Agency's loan closing. Closing procedures for the Agency's loan are identical to those described in Chapter 8. When the Agency's lien will be subordinated, the prior lien holder must execute *Form RD 1927-8, Agreement with Prior Lienholder*.

Field offices should work closely with leveraged lenders to minimize loan closing costs. It may be possible to use one title insurance policy to cover both the participating lender and Rural Development. The State Director should check with the Regional Attorney to assure this is an acceptable practice and obtain any special instructions to assure the government's interests are protected.

Leveraged loan packages that include any type of broker referral fee are not acceptable. Some mortgage lenders pay these fees for loans closed at a higher than prevailing interest rate. These fees must be disclosed in accordance with the Real Estate Settlement Procedures Act (RESPA). They are found on the *Form HUD-1, Settlement Statement*, as yield spread premiums, yield differentials, rate participation fees, par-plus pricing, or similar terms.

Mortgage insurance is **not** acceptable. This includes Private Mortgage Insurance (PMI), Mortgage Insurance Premium (MIP), and similar products.

Some lenders offer additional insurance products at loan closing, including mortgage payment insurance. Generally, the Agency will not approve a loan with such supplemental coverage unless the customer makes a written request for such coverage.

A. Required Documentation

In addition to the documentation required to support the Agency's loan, a copy of the mortgage, promissory note, evidence of title and hazard insurance, and closing documents for the non-Agency loan or grant must be provided for the borrower's case file.

There should be only one *Form HUD-1*. It should include all details of the transaction including Agency and leveraged financing. If the leveraged lender requires a separate *Form HUD-1,* a copy must be provided to Rural Development. The loan approval official will review the settlement statement(s) to assure leveraged customers are charged fees as agreed prior to closing. The review will include fees that are not part of the leveraged loan amount and/or those paid by the seller.

B. Recording the Lien/Legal Documents

The closing agent should be informed of the lien position the Agency will take.

In addition to recording the real estate mortgage or deed of trust, the closing agent will record the executed *Form RD 1927-8*. Among other features, this agreement requires the lender to notify Rural Development prior to declaring the security instrument to be in default and accelerating the loan.

ATTACHMENT 10-A

EXAMPLE: AGENCY FUNDS LEVERAGED WITH PRIVATE MARKET-RATE FINANCING

John and Phyllis Ford have been saving their money, hoping to buy a home. They have accumulated $4,000 toward a down payment and have kept their other debts low. In fact, their only ongoing debt is a $190/month car loan. John earns $20,000/year and Phyllis works in the home, taking care of their 3 children.

The couple has been house hunting on the weekends and has determined that their dream house is likely to be in the range of $70,000. Last week they approached a local lender about a loan. The lender explained that the Fords could not qualify for a loan because they could not meet the lender's down payment requirements and could not afford the monthly payments within the lender's required principal, interest, taxes, and insurance (PITI) ratio of 28 percent and total debt (TD) ratio of 36 percent at a 7.5 percent interest rate.

$70,000	Estimated Appraised Value
$70,000	Estimated Purchase Price
$ 7,000	Estimated Required Down Payment (10 percent)
$ 3,000	Estimated Loan Fees, Settlement Costs, and Initial Deposit to the Escrow
$ 110	Estimated Monthly Taxes and Insurance

To obtain a private market-rate loan, the Fords would need $10,000 in cash ($7,000 for a down payment and $3,000 for related costs that cannot be financed). They would also be required to pay $441/month in principal and interest. The resulting PITI and TD ratios would be 33 percent and 44 percent, respectively.

Based upon this information, the lender suggested that the Fords contact the Agency to obtain a Section 502 loan instead. The family qualifies for an Agency loan on the basis of income. They live in a rural area and are planning to purchase a home that is below the area loan limits for the area.

If the Fords receive a 100 percent Agency loan, no down payment is required and the appraisal and tax monitoring fees, as well as the contribution toward the escrow, can be financed.

Because the Fords are very low-income, they qualify for payment assistance at the 1 percent rate. Therefore, their monthly payment would be $215. This gives the family a PITI ratio of 20 percent and a TD ratio of 31 percent, well below the Agency's 29 and 41 percent maximums.

However, even though the Fords cannot afford 100 percent private financing, UniFi calculations indicate they could afford a leveraged loan with $20,000 provided by the lender, and the balance provided by the Agency and still meet the lender's PITI and TD ratios.

This arrangement would enable the Fords to meet the lender PITI and TD ratio requirements. The Agency's willingness to subordinate its loan to the lender's should help allay any lender concerns about loan-to-value ratio or a down payment. The Fords would not only get their dream house at a price they can afford, but also would establish a valuable relationship with a local lender. A leveraged loan would enable the Agency to assist this family using $52,500 of Agency funds, rather than $72,500.

Leverage Loan Terms

$ 500 Cash required from the Fords	
$20,000 @ 7.5% for 30 years =	$140/month
$52,500 @ 1.0% for 33 years =	$156/month
$73,000	$296/total monthly PI

$ 296 Principal and interest
$ 110 Taxes and insurance
$ 406 PITI (Ratio = 24.3%)
$ 190 Car payment
$ 596 Total Debt (Ratio = 35.7%)

ATTACHMENT 10-B

SAMPLE TOPICS TO BE ADDRESSED IN A MEMORANDUM OF UNDERSTANDING

In general, the lender will recognize Rural Development requirements for leveraged loans, particularly in providing required notices. A good Memorandum of Understanding (MOU) avoids future problems and strengthens partnerships.

ORIGINATION

- Agency will subordinate to permit lender to obtain first lien position when at least 20 percent of the total financing is provided.
- Lender must use standard application form and obtain Agency approval of qualifications for the appraiser, inspector, and closing agent.
- Agency will be responsible for the appropriate level of environmental review; however, the lender may be asked to assist in the collection of needed environmental data.
- The lender rates and terms will be the same as those offered to best customers obtaining similar mortgage financing.
- Agency makes independent underwriting decisions based upon reviewing the participating lender's origination package.
- A joint closing will be conducted and a single settlement statement provided. Closing costs will be controlled.
- For construction loans:
  - ◊ Describe how the lender will participate during the construction process (e.g., will the lender provide construction financing? will the lender defer amortization until the borrower occupies the dwelling?);
  - ◊ Describe how draws will be paid (a pro rata share from each lender is preferred);
  - ◊ Describe how inspections will be completed (e.g., if the lender completes inspections, the Agency must receive a copy of the inspection before making draw payments and an Agency inspector must make the final inspection); and
  - ◊ Describe what will happen if the Agency loan will close before the participating loan. For example, the lender must provide a firm commitment at the time of Agency loan closing, contingent only upon successful completion of the construction.

SERVICING

- Describe who will establish and maintain the escrow account. If the lender maintains the account, the lender must report annually to the Agency on the state of tax and insurance payments.

- Describe what information will be shared between lenders (e.g., results of periodic inspections, delinquency or default information). Note: Information provided by the applicant cannot be released to another party without the applicant's permission.
- Describe how each lender will:
  - ◊ Pursue joint special servicing actions if a problem arises;
  - ◊ Notify the lender in the case the loan is declared in default or accelerated;
  - ◊ Provide a reasonable period for the other lender to cure the default (i.e., through a new loan or advance) with the borrower; and
  - ◊ Pursue a joint foreclosure action if the borrower is in default on both accounts.
- Describe graduation review and the role of lender, customer, and Rural Development.
- Describe reporting requirements, if any.
- A copy of the MOU should be filed in each affected individual casefile.